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TAGS: ECON EINV EFIN ETRD BEXP KTDB PGOV SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER
DECEMBER 23, 2004 ISSUE

¶1. Summary. Each week, AMEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:
- Consumer Prices Increase Slightly Above Expectations;
- Western Cape Looks at Increasing Taxes;
- ICASA Proposes New Price Cap;
- Strong Rand May Subdue Inflation;
- Court Rules Against Pharmaceutical Pricing Regulations; and
- South Africa's Leading Business Indicator Still Increasing.
End Summary.

CONSUMER PRICES INCREASE SLIGHTLY ABOVE EXPECTATIONS
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¶2. In November, both overall consumer prices (CPI) and targeted inflation (CPIX, consumer prices less mortgages) increased above market expectations and above last month's inflation. CPI and CPIX increased 3.7 percent (y/y) and 4.6 percent, slightly above the market expectations of 3.6 and 4.4 percent, and above October's increases of 2.4 and 4.2 percent, respectively. Targeted inflation (CPIX) is expected to slow to 4 percent over the next three months as relatively lower expected fuel costs and the strong rand keep inflation under control. Major reasons for the 4.6 percent increase in CPIX include: (1) annual increases in the price indices for transport (+1.1 percentage points); (2) housing (+0.8 of a percentage point); (3) medical care and health expenses (+0.7 of a percentage point); (4) food (+0.5 of a percentage point); (5) education (+0.4 of a percentage point); (6) fuel and power (+0.3 of a percentage point); and (7) household operation (+0.3 of a percentage point). Source: Nedbank, Economic Research; I-Net Bridge, December 22.

¶3. Comment. While November inflation figures were slightly higher than expected, the strong rand will support a favorable short-term inflation outlook. Recent lower oil prices will also lead to further expectations of interest rate reductions during the next Monetary Policy Committee meeting in February. End comment.

WESTERN CAPE LOOKS AT INCREASING TAXES

¶4. Western Cape is considering increasing hospitality and commercial property development taxes as a way of generating development funds for the province. The additional income is expected to offset the pressures escalating social spending is placing on the provincial economic development budget. The studies investigating the feasibility of these new taxes should be completed by next year for the national government's approval. The province has applied to the National Treasury for the approval to charge a fuel levy of 10 rand cents/liter on motorists, which will raise about R300 million ($53 million, using 5.7 rands per dollar) for road, rail and other economic infrastructure maintenance. If the province gets approval, the taxes may be imposed by the end of next year. A 10 percent tax on commercial property development would raise about R250 million ($44 million) annually on this year's provincial development projects of about R2.5 billion ($440 million) for social housing and property development in low-income areas, while a hospitality tax could raise about R100 million ($17 million) annually for use in training and marketing of Western Cape's tourism industry. Source: Business Day, December 20.

ICASA PROPOSES NEW PRICE CAP

¶5. The Independent Communications Authority of South Africa (ICASA) is proposing that future price increases of Telkom (the telecommunication parastatal) be limited to

four percentage points below the rate of the CPIX (consumer inflation less mortgages), used as the inflation target by the South African monetary authorities. Currently, the regulations state that Telkom caps its annual price increase to 1.5 percentage points below targeted inflation. According to Telkom, the company's revenue would fall by R625 million ($110 million) if the new price-capping regulations were approved. (Telkom stated that a percentage point price increase translated into an increase in revenue of R250 million ($44 million)). Telkom itself proposed a cap of two percentage points below inflation. In 2003, Telkom received R40.6 billion ($5.4 billion, using 7.56, the average 2003 rand per dollar exchange rate) in revenues and an operating profit of R9.2 billion ($1.2 billion). Telkom has already filed a new price list for January 1 that lifts the cost of local calls by 5.5 percent and raises the cost of an overall basket of services by 0.15 percent. However, those price changes would have to be amended under the new rules. ICASA hopes Communications Department Minister Matsepe-Casaburri will approve its new regime in January, and it would ask Telkom to file new tariffs within 30 days. Telkom said if it must alter its tariffs again, it should have until August 1, which would be less "confusing," and would let its new prices be calculated on its financial figures for the year to next March. Source: Business Day, December 20.

STRONG RAND MAY SUBDUE INFLATION

¶6. The rand's renewed surge in the past two months has improved the inflation outlook for 2005 despite strong domestic spending, surging credit demand and rising unit labor costs. The rand has gained about 12 percent against a basket of trade-weighted currencies since the beginning of the year, and is expected to remain firm next year on the back of dollar weakness. According to Nedcor bank economists, the rand strength will hold into 2005 because of expected high commodity prices, positive investment sentiment due to potential sovereign risk rating upgrades, lower interest rates and stronger local growth. According to a group of economists surveyed by I-Net Bridge, CPIX is expected to edge up to 4.3 percent year on year in November, while producer price inflation should increase 2.3 percent year on year from 1.9 percent in October. According to Nedcor bank, the rand is expected to gain a further 10 percent against the dollar in 2005. Source: December 20, Business Day.

COURT RULES AGAINST PHARMACEUTICAL PRICING REGULATIONS
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¶7. The Supreme Court of Appeal ruled against the Department of Health's pharmaceutical pricing regulations by stating that the proposed dispensing fees were not appropriate. According to the court, the regulations did not consider the viability of the dispensing industry and the single exit price introduced a price control mechanism, which the Medicines and Related Substances Act had not intended. The Department of Health raised jurisdictional issues since the Cape High Court denied the industry a chance of appeal. The Supreme Court of Appeal dismissed these issues of jurisdiction by ruling that the Cape High Court's delay in granting leave to appeal was so unreasonable as to breach the constitutional right to a fair hearing. The regulations provided for a pricing system that defined a single exit price of manufacturers and a dispensing fee, which, for pharmacists, amounted to R16 without a medical prescription and R26 with a prescription. The court did not challenge government's right to administer prices but stated that the lack of any document describing how dispensing fees were calculated meant that the government did not consider the long-term viability of the retail drug sector. The Health Department was ordered to pay the court costs. Source: Independent Foreign Service, December 20; Business Day, December 21.

¶8. Comment. The Health Department plans to file an appeal against this court judgment in the Constitutional Court (equivalent to the U.S. Supreme Court), stating that international experts regarded the pricing regulations as reasonable and beneficial to consumers. According to the department, the single exit price set by drug manufacturers since June 2004 reduced the price of medicines by 19 percent. Drug retailers have long argued that the dispensing fee set by the government was so low that many retailers would be forced to close. Until the Constitutional Court rules, the existing price regulations have been rescinded and pharmacists are again entitled to charge varied dispensing fees, while manufacturers can charge different prices to different buyers. End comment.

SOUTH AFRICA'S LEADING BUSINESS INDICATOR STILL INCREASING
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¶9. South Africa's leading business cycle indicator is still showing growth, increasing to 115.5 in October, after September's rise to 115.1. The business cycle indicator has been rising since May 2003, as the economy is experiencing economic growth above inflation. The third quarter GDP growth of 5.6 percent is significantly higher than October's 4.2 percent CPIX's (consumer prices less mortgage costs) increase. Economic data and business confidence over the past few months point to a continuation of strong economic growth. The export sector has shown growth, but strong domestic demand has supported continued manufacturing growth. The leading indicator signals possible changes in the business cycle by six to twelve months and uses information on value of orders, job advertisements, productivity and average hours worked per factor worker as its components. Source: Business Day, December 21.

FRAZER